An Economic Analysis of the Hall Commission Report

Ontario Economic Council

A. Abouchar

Discussion Paper Series

AN ECONOMIC ANALYSIS

of the

HALL COMMISSION REPORT

A. ABOUCHAR

81 Wellesley Street East
Toronto, Ontario
M4Y 1H6

Printed in Canada.

This study reflects the views of the author and not necessarily those of the Ontario Economic Council.

CONTENTS

AN ECONOMIC ANALYSIS OF THE HALL COMMISSION REPORT*

I. INTRODUCTION

In May 1977 the Grain Handling and Transportation Commission (the Hall Commission) submitted a report, Grain and Rail in Western Canada, the result of nearly two years of research and local inquiries and investigation in the western provinces. Volume I appeared in mid-May and Volume II in July. A third volume, originally scheduled for completion before the end of May, has not yet appeared (September).

The Hall Commission investigated and made recommendations concerning a very wide range of issues concerned with grain handling, marketing, and transportation, issues as diverse as the establishment and introduction of new grain types and standards, standards for moisture content, grain transportation rate differentials, rates on secondary industry outputs, rail line abandonments, and capital improvements. The report has been fairly enthusiastically received in its entirety or in large part by many premiers of western provinces, transportation ministers and other officials, and others in public life in various political parties (The Globe and Mail, May 18, 1977, p.B3). Many representatives of the western provinces individually or in association have urged the federal government to implement the Hall recommendations immediately and berated the government for the deliberate pace with which it is approaching the whole range of issues to which the Hall Report is addressed, the most

---

*I would like to acknowledge the financial support of the Ontario Economic Council and the University of Toronto Institute for Policy Analysis in the preparation of this paper,and to thank Geoffrey Young for his comments upon an earlier draft. The earlier draft was the basis for a seminar held by the Council,and the present revision has benefitted greatly by discussion and criticism at that meeting. I would like to thank all the participants in the seminar,especially Om Tangri, Ihn Uhm, Rick Wansbutter, and David Winch for their comments at that time or subsequently, and Ann Abouchar for her editorial comments. Naturally none of those named can be presumed to share the views expressed here or can be held responsible for any remaining errors.

recent petition for action being a letter to Prime Minister Trudeau from Manitoba Premier Schreyer, sent on behalf of the four western premiers, urging faster action on the report (The Globe and Mail, Sept.1, 1977, p.B1).

While the Hall Report is of primary interest to the western provinces, it of course has direct and indirect implications for the rest of Canada as well. It is natural that the vast range of issues studied by the Hall Report should be couched within the framework of western interests and that the Hall Commission not necessarily evaluate every national implication of every one of the recommendations. However, any decision concerning the implementation of the report, in whole or in part, must recognize these implications in order that something close to a welfare maximizing decision be reached. In any event, if the whole report or selected recommendations are to be implemented, the other provinces must anticipate the effects of the recommendations on their local economies. Accordingly, a review and assessment of these implications has been undertaken and is presented in this paper. The main recommendations of the Hall Report are contained in Section II. The major implications for Ontario are analyzed in Section III. And Section IV is an attempt to analyze the major recommendations from a national welfare maximizing point of view. We remark that, while the main analytical framework is informed by the national or Ontario interests, it is often necessary to trace through some of the implications of certain of the Hall recommendations for the prairie provinces themselves.

II. THE HALL REPORT: MAJOR CONCLUSIONS

The Hall Commission Report (HCR) makes a number of recommendations which may be grouped under three categories: (1) line abandonment and amelioration; (2) railroad rates; and (3) miscellaneous grain, elevator, handling, and marketing policies. The summary and recapitulation of recommendations

presented in Volume I cover 26 pages. In this section, we will summarize this summary, adhering to the outline structure of the original presentation. Page references are to Volume I of the Hall Report.

A. The Railway System (pages 520-7)

1. Branch lines (pages 520-1). The Commission recommends gradual abandonment to 1981 of 2,165 miles of grain related prairie branch lines, the incorporation of 1,813 miles into the basic rail network, whose existence is to be guaranteed to the year 2000, and the subordination of the remaining 2,344 miles of branch lines under a new institution, the Prairie Rail Authority.

2. Prairie Rail Authority (pages 521-2). The Commission recommends the establishment of a Prairie Rail Authority, a federal crown corporation, headquartered in the west. It would lease all grain related branch lines which do not become part of the basic rail system for a nominal fee, contract with CN and CP Rail for train operation on these lines, contract for truck service, and generally ensure smooth provision of the various other administrative, operational, and financial arrangements in the public interest. It is anticipated that with the creation of the Prairie Rail Authority, subsidies to the railways would no longer be required for the grain related branch lines. However, it is anticipated that subsidies on these lines, larger than those now extended under the National Transportation Act to the carriers themselves, will be required: the Commission believes that the retention of these lines is in the national interest and subsidies in the national interest have long been an accepted procedure, and the commissioners "...have no hesitation, therefore, in recommending that the Federal subsidies now authorized by Sections 256 and 258 of the Transportation Act be replaced effective January 1, 1978, by a funding mechanism, sustained from general revenues

of the Federal government, adequate to sustain the Prairie Rail Authority in discharge of its duties as we have described them" (HCR, Vol. I, p.100).

3. Northern Development Railways (pages 522-3). A new system is recommended, encompassing the present Northern Alberta Railways, the Great Slave Lake Railway, the Alberta Resources Railway, and the Athabasca and Sangudo subdivisions of the Canadian National Railway. This is viewed as an important component in the development of a northern transportation system beyond that originally envisaged, with construction, as and when appropriate, of the Artic Railway through Inuvik.

4. Rail Car Utilization (pages 523-4). A number of procedures are recommended to improve car utilization, including: smoother interchange of grain traffic between carriers, non-exclusive assignment of government car fleet, 7-day unloading at terminal elevators, modification of box cars as necessary, and future coordination of hopper car orders with the needs of the Prairie Rail Authority, taking account of the lighter capacity lines of the Authority.

5. Rail Car Allocation (page 524). The Commission recommends that the Wheat Board provide more information on cars and availability.

6. Railway Subsidies (Resolution of Controversies) (pages 524-5). Expeditious resolution of the disagreements concerning claimed losses on prairie branch lines for 1967-1975, totalling 423.1 million dollars, of which 290.3 million has been paid, is urged. This requires cooperation of the C.T.C. and the lines.

7. The Producer Car (page 525). The Commission recommends that the Canadian Wheat Board undertake a program of producer cars and that various use and tax restrictions and regulations be modified to encourage the use of such cars.

8. The Ashcroft-Quinton Link (page 525). The right-of-way acquisition should be expedited.

9. Parallel Rail Lines (page 526). Parallel lines of the CN and CP on a number of arcs should be studied with a view to rationalization if there are savings in joint track usage.

10. Electrification (page 526). Transport Canada should study the electrification of Canadian railways.

11. Railway Right of Way (page 526). The benefits and burdens associated with public ownership of the road beds require additional study. An important recommendation of the Commission was that the right-of-way of all branch lines which have been or will be abandoned and not already disposed of should vest in the provincial crown.

12. Ancillary Charges (pages 526-7). The stop-off charge on grain which interrupts its journey for storage or milling in western Canada should be discontinued immediately.

B. The Primary Elevator System (pages 527-9)

1. Elevator Sites (page 527). The Commission recommends that elevator companies should have the option of purchasing or leasing sites from the railway at rates approved by the Canadian Grain Commission.

2. Off-Line Elevators (pages 527-8). A number of off-line elevators (elevators requiring special arrangements to gain access to the main rail line) are recommended either for study or for immediate establishment.

3. Elevator Tariffs (pages 528-9). The Hall Commission recommends that the Canadian Grain Commission standardize its costing and accounting procedures to determine the specific costs of individual operations, that primary elevator and terminal operators report costs regularly to the Commission, and that elevator companies show the relevant tariffs for individual operations on the producer's cash ticket.

4. Overbuilding and Closing of Primary Elevators (page 529). On lines under the Prairie Rail Authority's jurisdiction it is recommended that elevator companies obtain the approval of the Authority to expand or build new plants and that notice of intention to close elevators be filed with the Authority one year prior to the scheduled closing date. For elevators on the basic network the Canadian Grain Commission and the elevator industry should study the problem of overbuilding and develop an approach to prevent overbuilding and undue competition in some areas, coexisting with underservicing and lack of competition in other areas.

Ports and Terminals (pages 530-4).

A number of improvements in operating procedures are recommended for Thunder Bay, interior Canadian government elevators, Churchill, Vancouver, Squamish, and Prince Rupert. Many of these recommendations relate to utilization procedures (e.g. terminal switching) and administration (e.g. the responsibility of the Canadian Wheat Board for movements through Thunder Bay), while some relate to the economics of the situation (e.g. establishment of distance-related rates, comparable to the rates on the CN, for the CP points serving Churchill).

D. Economic Development (pages 534-6).

Following a general statement of its point of view,[1] The Hall Commission makes a number of recommendations regarding the enhanced development of individual industries, most of which involve modification of freight rates.

1. The Flour Milling Industry (pages 534-5). The location decisions of the flour milling industry should not be distorted through costing policies of the Canadian Wheat Board. These are now believed to distort location decisions by failing to isolate the directly variable costs of individual activities by region. (This is discussed at length in the Appendix to Chapter 7, HCR, Vol.II.) In addition, the present railway stop-off charges for storage and milling, which militate against the processing of grain in western Canada, should be eliminated.

2. The Rapeseed Crushing Industry (pages 535-6). The freight rates on rapeseed and derivatives should not discriminate against the natural locational advantages of the prairie crusher; the present inequities in rates which discriminate against movement of meal through Vancouver and Thunder Bay should be eliminated;[2] the

---

[1] "The production and processing of agricultural products should take place in the regions of this country which have a natural geographic advantage for such activities. Freight rates and other transport related policies should not destroy nor hinder these natural advantages. The Prairie Region of Canada is basically an exporting region, and hence a major contributor to Canada's balance of payments positions. Transportation policies should not detract from this position but should recognize its importance in the national interests " (HCR, Vol. I, p.534).

[2] The "inequities" referred to generally have their origin in the differentials between the statutory (Crow's Nest Pass) rates on certain products, including the input grains and on some of the products, and the much higher rates on many of the other products. For the particular case of Vancouver, the problem appears to be that the export price for the equivalent amount of seed (cont'd. on p.8)

railway surcharge on rapeseed meal in hopper cars (14¢ per hundred weight) should be eliminated; the same mileage allowance as is given for other shippers should be applied for tank cars used by rapeseed crushers; and the Federal Department of Industry, Trade, and Commerce should devote more effort to export promotion of rapeseed meal and oils.

3. The Livestock Processing Industry (page 536). Freight rates on livestock and meat should be set so as not to discriminate against the natural locational advantages of the western producers and processors.

4. The Malting Industry (page 537). To exploit the natural geographical advantages of location on the prairies, the railway stop-off charge for storage and processing should be eliminated; malting plants should be licensed as elevators and they should have the option of receiving malting barley directly from the producers and from primary elevators. The statutory freight rates on malting barley should continue and should apply to both malting barley and barley malt.

E. Transfers of Ownership (pages 536-7).

About 200 miles of Canadian National and CP Rail trackage should be interchanged between the two lines.

---

at Vancouver is low because the statutory rate applies, while the export price of derivatives, produced at Lethbridge, is considerably higher because the much higher rate on products exists from Lethbridge to Vancouver. Clearly, as far as the domestic market is concerned, this should make no difference - domestic rapeseed oil consumption would be satisfied by processing either at Lethbridge or at Vancouver. The real question here is why the statutory rate applies only to the export seed and not also to seed which might be crushed at Vancouver. Regarding exports, one has to wonder whether, even if seed for milling in Vancouver, for export, could be transported at the same price as seed, destined in unprocessed form for export, the crushing industry would gain momentum at Vancouver, since this is a relatively low level technology which is ideally suited to the industrial capabilities of most importing countries. The example is given in HCR, Vol. I (p.286).

F. The Canadian Transport Commission (page 537).

The Canadian Transport Commission, which under the National Transportation Act, now can order abandonment of railway lines, should be relieved of further involvement in abandonment proceedings on those lines committed to the Hall Commission for study and any lines placed under the jurisdiction of the Prairie Rail Authority.

G. Provincial Compensation for Road Costs (page 537).

Federal assistance should be given to provinces and municipalities for the higher road costs caused by any branch line abandonments.

H. Compensation for Tax Loss (page 538).

Abandoned rights of way should be returned to the respective provinces for disposal in consultation with local governments. The federal government should grant an amount equal to five years of taxes on lines recommended for abandonment which funds should be distributed to the municipalities in proportion to their tax loss. The funds should be paid immediately upon abandonment (page 517).

I. The Canadian Wheat Board (pages 538-9)

General approval was expressed for the role discharged by the Canadian Wheat Board and for the way it was performing this role. There is general support for the Board in the areas studied. A general recommendation was made that a more prominent coordinating role should be played in grain transportation and that regional offices be established in Alberta and Saskatchewan.

J. Other Important Producer Concerns(pages 539-44).

Here the Commission makes recommendations on a number of topics which came to its attention during the course of its hearings but which did not fall within the terms of reference of the Commission. Since the

Commission was not possessed of the necessary resources it could not examine the problems and implications of solutions as deeply as it would have liked to do. They are mentioned here by the Commission because they are of major concern.

1. Double-Grading Standards (page 540). The present system has two sub-classes - "primary standards" used to classify grain at the primary elevator and "export standards", used for exports out of terminal elevators. There may be large differences between them. According to some terminal elevator operators, doubling the tolerance of small seeds (from .15 percent to .3 percent) would increase the through-put of the lakehead terminals by up to 40 percent.

2. Protein Standards (pages 540-1). It is claimed that there is insufficient incentive to produce high protein red spring wheats.

3. Grading of Grain -- Moisture Content (pages 541-2). Evidence was presented in the report which strongly suggests that the present price system does not provide the incentives to combine inputs to produce the best output. This occurs because there is no price differential between 14 percent moisture, and 10 percent moisture content. Allowing the grain to dry from 14 percent moisture to 10 percent involves shrinkage, i.e. loss of volume, and also entails risk, grain being left in the field with the possibility of rain, discourages the achievement of the lower moisture standard, but earns no price premium.

4. Grading System and Utility Wheats (pages 543-4). The Commission reports the expression of the views of many producers in western Canada that new, lower grade wheat varieties should be introduced because there are markets for them both in Canada and in the rest of the world.

Canada has a reputation for high grade wheats and the Commission admonishes that this reputation should not be compromised. At the same time, the Commission supports the view that the possibility for introducing utility grade wheats, without compromising Canada's reputation, should be studied.

K. Statutory Rates (page 545).

"The Commission recommends: 1) The retention of the Crow's Nest statutory rates. 2) That the difference between the statutory rate and the cost of transporting grain be paid directly to the railways."[3]

Two comments should be made concerning the foregoing list of recommendations. First, in an effort to reduce their bulk from the 26 pages to the few pages in which we have presented them, we have for the most part forsaken direct quotation and resorted to paraphrasing, trying only to include all of the points of consequence. Usually we have included the specific citation for each item in the original list of conclusions which comprise Chapter 13 ("Summary and Recapitulation of Recommendations") of HCR Vol. I. In order to facilitate cross referencing we have followed the order of the original, citing the topic in which the recommendations fall and, in some cases, the first subordinate heading. The topic key (A, B, etc.) is adhered to in the original only through C, and we have thought it useful to extend this system through K, assigning a letter to each topic. Cross referencing is facilitated by our inclusion of the page number following each topic head.

---

[3] The question of direct payment arose because the Commission quotes British Columbia Minister of Transportation, the Honourable Jack Davis, to the effect that the federal government should "pay the farmer the difference between the present level of rates and a realistic level of rates, the latter being equal to the true cost of moving grain to the Coast " (HCR, Vol. I, p.337). The Commission recommends that any such difference be paid directly to the railways.

The second important observation concerning the conclusions is that, since we have attempted to summarize Chapter 13 without comment or addition, we have not listed here one important recommendation which was not included in the original. This is the investment for line improvement - $445 million - given in the analysis in Chapter 10 ("Grain Transportation Costs") also entitled on Page 313, ("Railway Rehabilitation, Rationalization, and the Cost of Moving Grain"). The ommission of this item from the list of conclusions in Chapter 13 is curious since it is so important and since other aspects of the network configuration, such as the retention of branch line trackage, are given together with references to the chapter containing the relevant analyses. The $445 million of investment was to be spent on the branch lines retained in the protected network and under the Prairie Rail Authority.

As we noted at the outset, the nature of the Hall Commission recommendations is extremely diverse. It is incontestable that those issues which the Commission recommends for further study should be studied, especially questions of standards, grading, and types. Secondly, many of the policy recommendations seem clearly desirable at present and should probably be undertaken directly, especially those measures having to do with operations and administration of elevators and ports and with the disposition and control of rail cars. Regarding many of the other issues there is likely to be more controversy and, indeed, the report indicates the controversial nature of some of its recommendations, such as the transfer of ownership of abandoned right-of-way to the provinces in which it is located (A.11). That there is likely to be some controversy surrounding the recommendations concerning the development of secondary industry is implicit in the subject, since opposing provincial interests are apparent here. What is not so apparent in regard to the recommendations under this rubric is the possibility of controversy within the western provinces themselves concerning these issues or, at least, the possibility that in fact the policy recommendations, if effectuated, might not have the

hoped for effect. Many policies do have implications for Ontario, although, for various reasons, most of them cannot be quantified. What is more important, however, are the implications of many of these policy recommendations for Canada as a whole; these are little explored in the Hall Commission Report but surely serious contemplation of their adoption at the federal level requires precisely such an analysis.

Other recommendations which appear to be unarguable include the elimination of rate distortions when these can be discovered. However, it is not patently obvious that any particular alleged distortion or inequity should indeed be construed as such. In the example cited previously - rapeseed through Vancouver - an alternative and reasonable interpretation of the apparent rate anomaly is that a pattern of rates has been advised to achieve a certain revenue objective, subject to the constraint implied by the statutory rates. Given the existence of the latter on a large amount of total freight moved, other commodities must be charged according to their demand elasticity, raising the rates for commodities with relatively inelastic demand to achieve a pre-set profit performance. If this total profit is too high, attention should be given by the Canadian Transport Commission to a complete review and revision of rates -- on rapeseed for processing at Vancouver, and on rapeseed products through Vancouver, and on children's bicycles, and ladies' dresses, and everything else. But it is not reasonable to single out any one particular rate to be reduced simply by comparing it with one or two, or even a dozen, other rates.

The following table classifies the Hall Commission recommendations from the viewpoint of their national welfare implications and their implications for Ontario. Many of the recommendations from the extensive list given above are not included in the table for the reason that they are not believed to have profound national significance or to be controversial, or to be of special concern for Ontario. These are, for the

TABLE 1

Classification of Hall Commission Recommendations From the Viewpoint of National and Ontario Provincial Interests

Recommendation	Important from	
	Ontario Provincial Viewpoint	National Viewpoint
A. The Railway System		
A.1 Branch Lines	X	X
A.2 Prairie Rail Authority	X	X
A.3 Northern Development Railway	X	X
A.6 Railway Subsidies, Resolution of	X	-
C. Ports and Terminals (Thunder Bay)	X	-
D. Economic Development		
D.1 Flour Milling	X	X
D.2 Rapeseed Crushing	X	X
D.3 Livestock Processing	X	X
D.4 The Malting Industry	X	X
G. Provincial Compensation for Road Costs	X	X
H. Compensation for Tax Loss	X	X
K. Statutory Grain Rates	X	X

most part, those which were stated in the last paragraph to be ready for implementation or, as suggested by the Hall Commission, to be deserving of further study.

We should stress that to say that some type of recommendation is of concern from both the Ontario provincial viewpoint and the national viewpoint should not lead us to expect the intensity or reason for concern to be the same.

Sections III and IV differ significantly in their approach. Section III, on Ontario, is an attempt to identify the implications of the Hall Commission recommendations; it contains no assessments of the desirability of the recommendations, its only judgments concerning what the discernible effects will be on Ontario. Section IV, on the other hand, does attempt to form judgments, from a national welfare point of view, concerning the desirability of various recommendations, taking into account as far as possible with the limited information available, the total impact on the national welfare, recognizing that some provinces may gain, while others may lose, and considering as desirable only those in which there is a net national gain, no matter to what province or region.

We now examine these conclusions from the Ontario provincial and national viewpoints.

III. IMPLICATIONS FOR ONTARIO OF HALL COMMISSION RECOMMENDATIONS

In this section we will consider those recommendations with implications for Ontario. We will consider them in order of increasing complexity, viz.: C - Ports and Terminals (Thunder Bay); B - Economic Development (the agricultural processing industries); G - Provincial Compensation for Road Costs and H - Compensation for Tax Losses; A - The Railway System; and K - Statutory Grain Rates.

III.1 Implications of Recommendations on Ports and Terminals (C)

The major implications for Ontario under this rubric concern the operations at Thunder Bay. There is little that can be said about these recommendations except that most of them appear to be conducive to smoother traffic flows at this port. While some of the recommendations relate only to the mode of operation, some recommendations involve money outlays, e.g. resumption of dredging, but since the Commission does not estimate the magnitude of the expenditures that would be required, we cannot do anymore at this stage than to state that some expenditures will be required and undoubtedly many of these would fall to the province.

III.2 Implications of Economic Development Recommendations (D)

Actually, the Hall recommendations on economic development are of two kinds: in the first place, there are those which are specifically cited under the heading Economic Development (HCR, Vol. I, pages 534-7), and here labelled D, and then there are those implicit in the endorsement of the development of the Northern Development Railway. The implications of the latter for Ontario lend themselves only to the roughest kind of qualitative speculation, which will be presented under III.4. A.3, below. Regarding the economic development of the agricultural processing industries, we can probably be a little more specific.

As we noted earlier, the Hall Report reflects the view that the location of major agricultural processing industries has been conditioned by distortions in the price of one major input -- transportation -- and so has proceeded in an irrational and an inefficient way over the years. This view is manifest in the many references to the need to develop in consonance with the natural geographic advantages of the various industries. The report feels that these irrationalities could be corrected by eliminating transportation price distortions.

The report attempts to categorize industries following the traditional location-theoretic criteria, according to which industries are raw materials-oriented, market-oriented, or untied, and believes that the location of agricultural processing industries, in the ideal situation, is raw materials oriented. For the four subject industries -- flour milling, rapeseed crushing, livestock processing, and malting -- this should lead to greater growth in the western provinces than has indeed been the case. However, in the industries considered, it is not clear that: (1) the weight loss is so substantial that the location should be input-oriented; (2) for those activities whose location should be input-oriented, it is not; and (3) a revision of rates would have the effect claimed. For example, consider livestock processing. In a comparative analysis (HCR, Vol. I, pp.306-8) the Commission shows the relative costs of alternative processes, reproduced here as Table 2. Clearly, under the rates hypothesized in this comparison, that process would be least attractive to easterners which is in fact the object of criticism by many western cattlemen -- shipping the feeder steer and the barley ($63.20). The most attractive alternative would be to bring in the dressed beef ($32.10). Bringing in the slaughter steer - i.e., fattening it in the west and shipping the steer for slaughter - in which case the west would retain a higher percentage of the value added, is the second most attractive alternative, and, depending upon the waste products might be the most preferred alternative, but the value in this case is probably not enough to justify it. The question, then, is why everybody would not choose the least cost alternative -- shipping the dressed beef at $32.10, giving the greatest value-added to the west. The answer has to be that, either the figures are wrong, or the eastern steer is not fattened on western barley. Indeed, since as the report points out on page 303, the eastern livestock producers depend increasingly upon their own grain production and U.S. corn imports, it is questionable whether any rate policy would have the effect of reversing the trend toward eastern feedlot activity. It is possible that rate adjustments would affect the competitive

TABLE 2: Transportation Charges for Feeder Steers with Barley, Slaughter Steers, and Beef from Selected Western Points to Toronto and Montreal, 1976

	Feeder Steer with Barley				
	500 lbs. feeder steer	4,120 lbs. of barley	Total	1,050 lbs. Slaughter Steer	550 lbs. of Beef
TO TORONTO					
From: Calgary	$ 20.50	$ 42.70	$ 63.20	$ 43.00	$ 32.10
Moose Jaw	17.50	40.30	57.80	36.80	26.40
Winnipeg	13.80	37.80	51.60	29.00	20.50
TO MONTREAL					
From: Calgary	21.10	43.50	64.60	44.20	32.10
Moose Jaw	18.10	41.00	59.10	38.00	26.40
Winnipeg	14.40	38.50	52.90	30.20	20.50

NOTES: 1) Slaughter steer transport charges calculated to nearest 10¢ from CFA Tariff 116-1, charges per railway installed double deck cars, assumed to load at 60,000 lbs. Tariff effective October 1, 1976.

2) Beef transport charges calculated to nearest 10¢ from CFA Tariff 103-U, 50,000 lb. carload rate for meats, fresh or frozen, effective September 1, 1976. The rates in this tariff are the same to Toronto and Montreal.

3) Barley transport charges calculated as Crow's Nest Rates to Thunder Bay and Canadian Livestock Feed Board charges to Woodstock, Ontario, in Toronto comparison and, less freight assistance to St. Felix, Quebec, in Montreal comparison.

SOURCE: HCR, Vol. I, p.306.

position of Ontario in third markets where western and eastern producers are competing, although this does not seem a very substantial potential battleground given the distances and population concentrations existing today.

Further support to the view that changes in railroad rates would have little effect on the eastern meat-packing industry is given by the recent study prepared for the Federal-Provincial Committee on Western Transportation, entitled Two Proposals for Rail Freight Pricing: Assessment of Their Prospective Impact. The objective of both these proposals was to bolster the position of western industry. These two proposals, known as the Equitable Pricing Policy (EPP) and the Destination Rate Level Technique (DRL) both reflected an attempt to standardize rail rates, the first, in terms of type of car, and the second by point of destination, requiring that any shipment of any "specific commodity to a given destination be set at the lowest uniform percentage mark-up over variable cost which may be applicable to a corresponding car load from any origin. The proposal leaves railway management with the option of meeting or ignoring competition as it sees fit" (FPCWT, p.4-5). The present situation and the impact of these changes on the meat and poultry industry and the feed industry are shown in Table 3.

TABLE 3

Railroad Freight Charges in Relation to Value of Eastbound Shipments of Meat and Poultry and Feed Industries: Actual Ratios and Ratios Under Two Alternative Pricing Policies 1971 (%)

	Actual	EPP	DRL
Meat and Poultry	1.93	1.46	1.86
Feed	5.19	2.69	4.95

SOURCE: FPCWT Report, p.5-6.

As the table shows, while eastbound movements of meat and poultry under the rate proposals falls a little from the present level, none of the percentages accounts for more than 2 percent of the value of shipments, and, hence, a much lower percentage of final retail price. However, the proposals lead to a reduction in the relative charges on eastbound shipments in the feed industry, thus enhancing, if anything, the role of the feedlots in the east. In fact, the percentage changes and the levels implied by the two rate proposals are small and probably would have little effect on the relative positions of the eastern and western producers, but we can certainly say that they would not enhance the position of the western producers.

Since both of the new rate proposals attempt to impose a common basis for rate making throughout the industry, apart from the present statutory grain rates, one could only at great risk claim to find discrimination, used pejoratively, in the rate impact simulations. In fact there is not only no discrimination in the pejorative sense, but also there is very little in the economic efficiency sense relevant to the apportionment of joint cost. The DRL method, since it is destination- and commodity-oriented, does leave room for discrimination and reaction to the competitive strength of alternative modes.

It is also of interest to look at the flour milling industry, since the report devotes a great deal of attention to it. Here there is some weight loss in milling, a factor which argues in favour of an input-oriented location pattern. The Hall Commission Report seems to argue that this industry had developed a market-oriented location primarily because of various price premiums and discounts, including e.g., stop-off fees on domestic flour shipments milled en route which have encouraged the location of the industry in the east. (Both flour and grains move to select points under the Crow's Nest Pass rates so that this cannot be construed as a discouragement to western milling.)

Several questions must be asked concerning this argument: (1) is the weight loss sufficient to justify processing at the point of grain production considering that (a) if the flour is shipped in bags, there are higher costs in loading and unloading, and (b) if it is shipped in bulk there may be higher dust loss en route and increased spoilage. Since the weight loss is not substantial in the first place, it is probable that the higher costs implicit in transporting milled flour would offset the saving implicit in not transporting the grain which is wasted in the course of processing (around 20 percent).

Finally, since the transport costs constitute a very small fraction of wholesale flour prices (less than one percent of the value of inbound Ontario flour and breakfast food according to the FPCWT Report (p.3-16)) it is unlikely that any change of the order of magnitude suggested by the report would matter to the location of the industry in Ontario.

Much the same reasoning would apply to the rapeseed crushing industry and the malting industry.

III.3 Provincial Compensation for Road Costs (G) and Compensation for Tax Loss (H)

Both of the items treated here result from line abandonments.

First we treat road costs. The costs incurred by provinces and local governments to maintain the highway network will rise as traffic is forced to move over the roads after rail connections are removed, and it is recommended that the federal government assist these governments in meeting these costs. It is implicitly assumed that the revenue generated by this traffic through user charges will be insufficient to cover these higher expenditures and outside support will be necessary. No estimate of the total incremental deficit or suggestion concerning the extent of federal participation in meeting this deficit is made in Chapter 12 of HCR, Vol.I, where the matter

is discussed. (We return to this topic in Section IV to comment on the welfare implications of the deficit and of the implied user charge structure.) Federal participation implies, however, either an increase in overall federal tax revenue, or a reduction in some expenditure now being undertaken, and we would assume the latter to be more probable.

Regarding the other item treated here -- Compensation for Tax Loss of Local Governments -- we can make the following rough estimates. The total provincial and municipal taxes paid by the railways in Manitoba, Saskatchewan, and Alberta in 1975 was $15.9 million, according to Statistics Canada (Railway Transport, Part I, 1975, p.16). We would probably not seriously err if we assumed that this tax was proportional to mileage, so that the suggested withdrawal of 2,165 miles, about 9 percent of the total mileage operated in these provinces in 1975, implies a reduction of $1.4 million in annual tax revenues for the governments affected. If we assume, further, that Ontario contributes 25-30 percent of this total, the Ontario contribution for the five years to compensate for the loss in tax revenues would be around $2 million.

III.4 The Railway System

Four items are mentioned here as having significance from the viewpoint of Ontario. Three of the recommendations - A.2 (Prairie Rail Authority), A.3 (Northern Development Railway), and A.6 (resolution of controversy between the CTC and railways concerning the justified railway subsidies) are less consequential and will be treated first. The other item - A.1 (branch lines) - has either larger or more immediate implications.

A.6. Resolution of Controversies Surrounding Railway Subsidy Claims

Our concern here is the $132.8 million for the period 1967-1975 whose payment has been the subject of dispute between the CTC and the prairie lines. The Hall Commission

recommends that the CTC report to the Minister of Transport by July 31, 1977 to indentify the various legal and accounting issues and the amounts owing on each branch line and advise the railways of the items to be disallowed, giving the reasons for its decisions. As with items G and H, a decision to allow some or all of them will have implications for federal expenditures in Ontario. Perhaps the best judgment is that 15 to 20 million dollars would come out of expenditures which would have otherwise been made in Ontario.

A.3. Northern Development Railway

The Northern Development Railway is a proposed consolidation of small independent lines in Northern Alberta (including the Great Slave Railway which extends into the Northwest Territories), and certain northern lines of the CN system in Alberta. The Northern Development Railway, known as the North West Railway Authority, as well, would also involve addition of 455 route miles of new construction to gain access to various mineral sites and agricultural areas. A total expenditure on new construction of between $218 and $385 million is indicated (HCR, Vol. I, p.110). According to the Hall Commission, the estimated probable total expenditure on new and improved railways to be part of the initial North West Railway Authority would be between $448 and $615 million, including $230 million on the rehabilitation or improvement of existing railways.

As we suggested earlier, many of the implications for Ontario of the Northern Development Railway are remote. In the future, the tributary region of the Northern Development Railway, and, indeed, all of Alberta would probably grow faster than Alberta is presently doing, and would either grow faster than Ontario or, at least, grow faster in relation to Ontario than is now the case. No welfare significance can be attached to such a comparison, however. On the other hand, faster development, assimilation of new minerals, and the expansion of capital investment in the region, whether

in the form of the proposed initial investments or the subsequent investments in rolling stock, related facilities, and industrial projects which would be undertaken later, have positive implications for Ontario industries, difficult to specify though they may be at present.

A.2. Prairie Rail Authority

The main relevance of the proposed Prairie Rail Authority to the analysis of the Ontario economy arises in the subsidies which may be required. To recall, the Prairie Rail Authority is to be responsible for operation of 2,344 miles of prairie branch lines, with the continuation of operations on these lines being reviewed from time to time; of course, the subsidies now extended to lines which may be abandoned would fall. On the other hand, an unspecified amount of investment is suggested for the lines of the Prairie Rail Authority. This total is not spelled out in Chapter 4, where the organization and operation of the Prairie Rail Authority are discussed most extensively in the Hall Commission Report; it is not clear, although it appears to be the case, that the investment in these lines is part of the $445 million of investment recommended by the Commission for the prairie branch lines in Chapter 10 (see next item). The commission does not expect that the Prairie Rail Authority will have any "mandate to operate 'gold-plated' railways" (HCR, Vol. I, p.102) and it urges that it "manage the funds entrusted to it in such a manner as to correlate roadway expenditures with anticipated road property service lives, balancing on each line quality service for the longest periods possible, with minimal residual values in the road property entrusted to it. In many cases this may mean continued minimal maintenance and low operating speeds" (HCR, Vol. I, p.102). If this is the case, subsidies out of general federal revenues on account of prairie rail transportation of grain should not rise on that part of the network which is retained for operation by the initial Prairie Rail Authority, unless it turns out to be the case that the level of maintenance is, while not "gold-plated", still more than is being expended on the lines by

the CN and CP today. That this might be the case is suggested by the statement in the Hall Commission Report that "the lingering Prairie suspicion that funds meant to keep the grain-related branch lines functioning were expended on other parts of the railway, or disbursed as dividends, will be at an end" (HCR, Vol. 1, p.102), which implies the belief that more should be spent on maintenance than has been the case. Finally, we point out that the comparison so far made has been between expenditures in the future and today only on that part of the network which is retained for operation by the Prairie Rail Authority. As noted earlier, the abandonment of 2,165 miles of prairie branch lines will lead to higher road costs which, if it is true that the trucks are not now paying their directly variable cost, will also require a subsidy from all the provinces, including Ontario.

A.1. Branch Lines

The Hall Commission Report recommends the following disposition of the 6,322 miles of prairie branch lines: abandonment - 2,165 miles; incorporation into basic rail network, to be guaranteed to the year 2000 - 1,813 miles; transfer to Prairie Rail Authority - 2,344 miles.

The mileage which is to be retained is to be upgraded through substitution of heavier rail, cleaning of ballast, replacement of ties, rehabilitation of bridges, new fencing, and other improvements. The Hall Commission analyzed the estimates of the CN and CP and prepared its own estimate, which differs from the former both because unit cost estimates differed somewhat and the Commission was recommending the abandonment of approximately one-third of the total, while CN and CP estimates assumed no abandonment. The estimates are summarized in Table 4, which reproduces Table X-8 from page 327 of volume I of the HCR.

The Hall Commission is not explicit concerning the source for this capital investment, but the tone of the report suggests

TABLE 4: Estimates of Capital Required (1974 Dollars in Millions)

	Upgrading the Complete Existing Network		Combination of Upgrading and Rehabilitating the Complete Existing Network		To Provide The Adequate Network - Configuration Recommended by the Commission
	According to Rly. Companies	According to Commission	According to Rly. Companies	According to Commission	According to the Commission Estimate
CN	1,204.7	758.4	360.4	524.1	297.5
CP	532.7	615.8	176.7	160.9	133.0
NAR	8.3	14.5	2.1	14.5	14.5
TOTAL	1,745.7	1,388.7	539.2	699.5	445.0

SOURCE: Hall Commission Report, Vol. I, p.327.

that it intends it to come from the federal government rather than be recovered from users or be paid for by the provinces. In this case, a large amount -- perhaps 25-30 percent -- would come from reduction in expenditures which would otherwise be made in Ontario. Partially offsetting this total is the reduction in subsidies now granted under the National Transportation Act to the 2,165 miles of branch lines that would be abandoned. It is not possible with generally published data to estimate this subsidy precisely. The Commission made some cost per mile estimates based on CN data as detailed in the report of the Commission on the Costs of Transporting Grain by Rail. "This resulted in a total of $7.9 million for an average reduction in train operational expenses equivalent to $3,120 per mile of abandoned track" (HCR, Vol. I, p.332). If we assume that 30-50 percent of this is recovered from users at present, this implies an annual subsidy of around $4-5.5 million which would be avoided in future, with corresponding effect on Ontario.

III.5 Statutory Grain Rates

The Hall Commission Report recommends that the statutory rates (Crow's Nest Pass rates) be retained, and that any difference between the revenue generated by the statutory rates and the cost of transporting grain be paid directly to the railways by the federal government.

The statutory grain rates today, which grew out of the original Crow's Nest Pass Agreement rates, covered grain and grain product shipments (including flour) from the prairies to: (1) Thunder Bay and Armstrong, Ontario; (2) Pacific Coast Terminals for export; and (3) Churchill for export. The main implications for Ontario are of three types: (1) to the extent that the statutory grain rates do reflect a subsidy, Ontario, along with all the other provinces, has to contribute toward the subsidy, not directly, since losses on grain movement are not officially recognized but, rather, indirectly to the extent that losses may be ascribed to general operations

on the prairie branch line whose subsidization is allowed under the National Transportation Act; (2) prices of grain for Ontario consumption are lower, benefitting thereby Ontario consumers, and also making Ontario less self-reliant in certain agricultural products, reducing somewhat the incentive to local grain production; and (3) improving the competitive position of Ontario's lake ports for export, although even without the statutory rates the combination of rail to the Lakehead and water to Montreal would probably continue to be a cheaper routing than would rail to Montreal. The rates are unlikely to affect the nation's total grain exports, since world grain prices and demands are probably little affected by production costs in any single country, even a large producer like Canada.

On the whole, it would seem that the statutory grain rates have little net impact on the economy of Ontario.

IV. THE HALL REPORT AND THE NATIONAL WELFARE

In this section we will evaluate the recommendations of the Hall Commission Report from the viewpoint of their impact on the nation's welfare. The recommendations which require evaluation were shown in Table 1. The recommendations not specifically listed there are believed to be generally conducive to the promotion of the nation's economic welfare and are not controversial. Those listed in Table 1 are believed to be controversial, to require illumination or qualification, or to be of major potential impact justifying specific mention here. But besides having a different point of view in this section as compared with Section III, the procedure will also differ. In Section III we commented on each specific item which might be relevant to the Ontario economy, while here, many of the same considerations apply to most of the items, and it is believed preferable to start by presenting the criteria for evaluating the individual items from a welfare maximizing viewpoint, and then show how the individual items are affected. Only one item -- The

Northern Development Railway (A.3) -- requires analysis that does not fit into the analytical framework within which all the other issues can be investigated, and this may be disposed of quickly. The Northern Development Railway appears to have tremendous economic potential and, if it is consistent with social constraints in the northwest, further study of the project and tributary area is justified. We would expect that the Alberta public sector, together with private capital, would be the primary engine of development, since there would not appear to be any justification for federal participation on income distribution or allocation efficiency grounds.

All of the other recommendations which have been identified as having national implications have in common their involvement with the transportation rate structure. Because either the transportation rate structure is at the root of many of the grievances which the Hall Commission recommendations attempt to set right, or an appreciation of the logic and role of transportation rates is essential to the analysis of the welfare implications of the Hall Commission recommendations, we will start with some general comments about rate policy in Section IV.1. In this discussion, many specific allusions are made to the analysis and recommendations in the Hall Commission Report, but a systematic enumeration is given in Section IV.2, which, after the discussion in Section IV.I can be brief.

IV.1. Transportation Rates and the Canadian Economy: Some General Considerations

The risk of banality in presenting the following comments is accepted by the author because of his belief that, trite through the observations may be, they bear repetition because writers and formulators of transportation policy so frequently confront these or similar arguments, recite them, and blithely move in a different direction, because, of course, special considerations are relevant in the special case under discussion.

The system of prices facing buyers of goods and services is a critical influence on the efficiency of operation of the economy. If these prices reflect the true social costs of providing the goods and services, buyers, while looking after their own well-being, will make decisions which are efficient from the larger social point of view. Producers will be stimulated to use processes, and inputs into their production processes, which will provide a profit in excess of their own private costs, which at the same time reflect the costs to society, and they will refrain from using goods and processes which would cause them to make a loss: in other words, if they calculate their profit and loss in terms of costs to society, society will be better off. The key requirement for this desirable state of affairs is that private costs should at the same time be social costs, that the prices facing the private producer or consumer should correctly reflect the true burden that his decision places upon society.

The rule just prescribed is just as valid for the transportation sector as for any other part of the economy. However, in the transport sector it is usually very difficult to measure the true social costs in order to judge whether the prices facing the users of transport services are correct. But, since the transport sector pervades the activities of the economy, if the prices paid by the users for transport services do not reflect true social costs, the prices of derived products at subsequent stages of production will almost certainly not reflect true social costs. Thus, while it is harder to determine what are the true social costs of individual transportation activities than it is for other goods and services, it is probably more important to do so just because these services enter into the production of most other goods and services in the economy.

One exception from the foregoing rule about equalization of private and social costs is the case when it is desirable to achieve some income distribution objective through the

price mechanism. But even here a deviation between price and cost should be considered only when it happens to be more efficient to achieve the given income distribution objective in this way rather than through direct income transfers. A second exception from the foregoing prescription is the case when some political or military objective dictates the inception of some transportation activity, whose cost then should clearly not be recovered from the users. Both of these exceptions are or have been of some importance during Canada's history. For this reason, and for the reason that they are frequently invoked even in situations in which they really are not relevant, we mention them here and will return to them shortly.[4]

That the Hall Commission Report tends to neglect these truths must be apparent from the mere enumeration of the recommendations in Section II of the present evaluation: the farmer is explicitly absolved from payment of the full cost of transporting grain; federal assistance should be given to the provinces to defray part of the cost of the increased highway traffic following rail line abandonment, thus recognizing and accepting the fact implicit therein that this class of truck is not now paying the social cost which they impose upon the system; no attempt should be made to incorporate into the cost base for prairie grain transportation the proposed investment of $445 million to rehabilitate or upgrade the prairie branch grain lines recommended for incorporation in the system protected to the year 2000 and in the part of it to be operate under the Prairie Rail Authority. Neglect of these basic truths is manifest in the failure to consider whether the

---

[4]An attempt to classify and distinquish the various economic, social, and political motives for less-than-full-cost pricing is presented in Abouchar, Transportation, Economics, and Public Policy: With Urban Extensions, New York, Wiley-Interscience, 1977, to which the reader is referred for further discussion of these issues.

various premiums and surcharges, alluded to as inequities or distortions, may simply reflect the laudible attempt of a firm attempting to cover total costs, less statutory subsidies, subject to the low revenue constraint imposed by the legacy of the Crow's Nest Pass. To say this is not to suggest that the railroads in the absence of regulation would have the public interest uppermost in mind -- certainly the degree of monopolistic power that they possess would preclude any naive belief that this was the case since the fundamental requisites for competitive optimization are lacking. Nor do we suggest that there are no questions about the way that regulation has taken place or the game rules that have been followed and, indeed, the Hall Commission invites attention to several procedures which it feels are inconsistent with the original intent of the regulatory legislation and the game rules (HCR, Vol. I, p.59).

As we noted above, conditions may be envisaged in which it is desirable not to recover from the users the full cost of providing the transport activity. Much of the construction of the Canadian Pacific in the first place was supported by loans or grants by the government whose objective was political - to extend confederation to the Pacific. Given this political objective, we should not expect or wish to see the cost of constructing this line incorporated into the cost base used to determine transport prices. A similar argument has been used to justify the rate concessions granted under the Maritime Freight Rates Act. According to this reasoning, these concessions were intended to compensate the Maritime provinces for the loss that they suffered from confederation after expecting gains therefrom, due in part to their surrendering control over their customs and redirecting their trade relations to Canada rather than the United States. This justification was strengthened by the fact that the route of the Intercolonial Railway linking the Maritimes with Canada -- far from the U.S. border and uneconomically circuitous -- was dictated by military-political considerations, for which the Maritimes should not have to pay (Currie pp.113-122).

Can any reasonable arguments be found to justify the continued subsidies to prairie grain traffic?

Justifications there are in the Hall Commission Report for preferential treatment for the prairie grain economy, but one searches in vain for a valid justification based on national economic welfare maximization or national political purpose. The Report contains statements such as the following

> "The unique Canadian situation is unlike any other major grain growing and exporting country. Canada is absolutely dependent on rail transport to move grain from where it is grown to export position " (HCR, Vol. I, p.2).

Apart from questioning the uniqueness of Canada's position -- the U.S., the U.S.S.R., Argentina, and Australia, the world's other major grain producers, quickly come to mind as sharing Canada's dependence upon railroads for their grain export -- one has to ask, "so what? Why does this mean that transportation for export should be subsidized?" To suggest that this should be the case would also require support of the view that wood pulp should be subsidized because it is an important export, heavily dependent upon transportation; likewise with other raw materials and other agricultural products. But why should it stop with primary inputs? And why with transportation services? Why not subsidize anything which might become an important export? Why then restrict the subsidy to important exports and not extend it to any potential export, on the ground that lots of little exports can become the equivalent of a single big export?

Numerous references throughout the text to the contribution of Canada's grain production to the export surplus,[5] are given

---

[5] The Hall Commission "...feels that the government must continue to subsidize the transportation of export grain and that the full cost, as deemed by the Commission on the Costs of Transporting Grain by Rail, must not be imposed on the producer. The contribution Western grain makes to Canada's balance of payments position demands that a substantial part of any increase be borne by the federal government in the National interest" (HCR, Vol.I, p.336).

in support of low grain rates without any logical analysis. To say that a commodity is valuable simply because it generates export earnings without reference to the cost of exporting it is not meaningful. In fact, it is probable that at recent world export prices, Canadian grain could easily cover the total costs of producing and shipping it. However, conditions can be imagined under which it might be desirable to give some subsidy to grain export. For example, given the vagaries of the international grain market, if higher rail transportation costs became a first call on the earnings arising in grain exports, followed by the farmer's mortgage, his annual operating loans, his materials purchases, and so on, the residual accruing to him as income would in consequence of the wide year-to-year grain price variations, fluctuate widely, thus constituing a serious income problem and possibly accelerating the departure from the land. Therefore it might be desirable to extend a subsidy to grain production. However, the most efficient way to do this cannot be through a freight rate subsidy, since adjustments in freight rates cannot be counted upon to be speedy or of the correct magnitude. Rather, the proper economic lever would appear to be through a system of compensating payments to the farmers by the Canadian Wheat Board or the provincial wheat pools, subsequently compensated by the federal government. What we are picturing is a system in which a minimum target income is set for the farmer, a target immune to year-to-year variations in world grain prices. When prices are high, part of the difference between the total export earnings and the sum of the total expenditure on transportation, materials inputs in production, and the target farmer income, would accrue to the administering agencies, and in years of depressed prices, the difference would move in the other direction out of the previously accumulated surplus. This policy has the advantage of being easy to administer and control since the administering authority would be intimately aware of market trends and prices and could make the adjustments quickly. To appreciate that there would be real national gains in this, it is

enough to look at the situation of the past few years. In 1975 after grain prices had more than doubled, a strike in a critical sector (the grain handlers) served to reduce farmer income. But it did not necessarily transfer it to the grain handlers since there was a prolonged layoff, large backups in transport pipelines, large demurrages paid for ships awaiting loading in ports (a dead loss on this account), and subsequent loss of orders by major customers because of the difficulty that they were experiencing at the time. For example, Japan and China subsequently transferred large orders to Australia.

In advocating that the Canadian transport sector work toward the elimination of subsidies which reflect departures from incremental social cost (and which are not caused by prices which are set at low levels for income distribution objectives), which notion corresponds essentially to the marginal cost concept in the usual theoretical elaboration, the author is aware, of course, that he is challenging what has become a respectable tradition -- the "second best" approach to the defense of subsidies in various industries or sectors. But if economics is to serve in a more substantial way than as a parlour game, critics who follow this approach should be asked to tell us where, how much, and what form the departures should take. This is never done. Consequently, the appeal for yet another compensating price offset to counter some existing departure from marginal cost is often cloaked in theoretical respectability while in actuality it represents simply another attack on the public purse. The late August appeal by segments of the merchant marine industry, couched in less theoretically respectable terms, but also "justified" by appeal to subsidies already granted to existing modes of transport, is a recent example of the wave effect of subsidies to individual transport modes.

Against the background of the foregoing views we can now make judgments about the major Hall Commission recommendations

from a national welfare point of view.

IV.2. The Hall Commission Recommendations Viewed within the Context of National Welfare Maximization.

In view of our comments in Section IV.I concerning the role of the price mechanism in the economy we make the following comments on those Hall Commission Recommendations which are of major national consequence.

A. The Railway System

A.1. Branch Lines

It is not clear what standards the Hall Commission used to decide which lines should be retained in the basic network protected to the year 2000 and which lines should be assigned to the Prairie Rail Authority. It would be presumptuous for an outside observer without access to this information to attempt any judgment about the procedures employed. However, we would not accept the notion that the investment of $445 million should be paid for out of public funds and not subsequently incorporated into the rate base. We believe that the reasons for this view have been sufficiently developed above.

A.2. Prairie Rail Authority

If by establishing the Prairie Rail Authority, those branch lines which are marginal in their contribution to railroad revenues and which require subsidies under the National Transportation Act as presently constituted (primarily those subsidies relating to uneconomic branch lines), are separated from the rest of the network, so that future subsidies to the general network can be eliminated, thus avoiding the problem earlier referred to caused by the alleged diversion of subsidy funds from use on the lines for which they were declared in the first place to use elsewhere, and some assurance can be given that no further subsidies would

be required on the basic network, there would be much to recommend the establishment of the Prairie Rail Authority. Recognizing that the traffic density on these lines would be low, which, if total cost on the lines were to be recovered would lead to high rates, it might be appropriate to retain low subsidized rates only on these lines as an income distribution measure. Care should certainly be exercised to ensure that said lines do not become "gold-plated", to use the words of the Report, or even "chrome-plated". Indeed, it might be appropriate here to question whether any capital improvement should be undertaken on these lines; if the tributary lands are indeed marginal, providing better service to them would only serve to promote their continued employment while yet these lands are almost by definition not capable of paying the full cost of the resources devoted to their working (including a target income for the farmer).

D. Economic Development

The main thrust of the recommendations here is to modify the alleged distortions and inequities in the present freight rates structure which lead to a suboptimal location of these industries. The optimal location is claimed to be much more heavily western-oriented than is the situation which has evolved. The argument is expressed in various ways throughout the text. For example:

> "The production and processing of agricultural products should take place in the regions of this country which have a natural geographic advantage for such activities. Freight rates and other transport related policies should not destroy nor hinder these natural advantages. The Prairie Region of Canada is basically an exporting region, and hence a major contributor to Canada's balance of payments position. Transportation policies should not detract from this position but should recognize its importance in the national interest " (HCR, Vol. I, p.534).

Elsewhere, the Hall Reports speaks of the

> "'natural' locational advantages as opposed to 'created' locational advantages. Any variation from a 'natural' locational advantage is a distortion. It is difficult to define distortions resulting from freight rates and transport policies because of the long standing nature of policies such as statutory rates on grain and Feed Freight Assistance.[6] For many people, these policies are 'natural' rather than being distortions. Despite the difficulties involved in describing the 'natural' competitive environment of many industries, it is possible and indeed very useful to explore the effects of certain 'distortions' (or groups of 'distortions') on the locational advantage of firms. However, it should be kept in mind that the remainder of this chapter considers only freight rate and other transport related distortions, and not any of the other factors that may lead to changes in the location of agricultural processing " (HCR, Vol. I, p.279).

Elsewhere the Hall Commission Report identifies the diminution in the relative share of the western agricultural processing industries with the narrower interests of western Canada itself rather than of the nation as a whole.

> "The application of technology to agricultural production allowed expansion of farm size and a decrease in farm labour. The products of agriculture have continued to flow out of western Canada in their raw form. Therefore employment opportunities and opportunities for population expansion in Prairie Canada have not kept pace with the expansion in the rest of the country" (HCR, Vol. I, p.274).

---

[6] Feed Freight Assistance is the program which began during World War II to encourage local eastern stockraising and meat packing. The subsidy under this program has been around $20 million annually - around 10 percent of total direct subsidies to the railways (Darling, pp.49,54).

In the discussion of the implications for Ontario we cautioned that any "distortions" or "inequities" should be analyzed carefully to see whether they may simply constitute a desirable form of discrimination in the assignment of joint costs. All citizens - Westerners, Ontarians, Quebecois, Maritimers, or Newfoundlanders - should be concerned if resources are being used wastefully. Our earlier comments on the role of the price mechanism should help us to understand the need for prices to reflect the true social cost of providing the activities. As we said in Section IV.1, it is often the case that, from the standpoint of efficiency, joint costs must be allocated according to the elasticity of the demand for transportation of the product, which in turn is a function of the elasticity of demand for the consumption of the product. We should not instinctively reject the notion of differentials in prices in such cases and it is not helpful to refer to them as distortions or as inequities, or, for that matter, as "discrimination" when that word is used in a pejorative sense, unless the analyst has at his disposal a great deal more information than the Hall Commission presents on the subject.

Indeed, as one of the quotes given above indicates, the Commission has difficulty in classifying and analyzing the natural and created locational advantages, and its use of quotation marks around "distortions" suggests that even the Commission does not really believe that the resulting pattern of location does reflect market distortions. The fact of a dispersed locational pattern for these industries is certainly insufficient evidence to indicate the existence of distortions, and the few items specifically analyzed in our identification of implications for Ontario in Section III suggest that this may not be the case. To be sure, a major impetus to the original development of the eastern stock raising and meat packing industries must have been the Feed Freight Assistance Act in the first place. But that it should have been believed necessary to introduce such a policy may

itself have been the result of previously existing "price distortions" or, to phrase it more neutrally, price discrimination in the form of higher transportation prices for feed grains out of the west to help recover some of the joint costs that could not be recovered from the grain traffic covered by the statutory grain rates!

The Feed Grain Assistance subsidies have continued to the present, and, although the annual tonnage moved under these subsidies has been fairly stable since the early years of the program (around 2-3 million tons annually), and the total expenditure has also been fairly stable (around 20 million dollars annually since the mid-1940's), the subsidy does constitute a distortion, however small it may be. We would certainly agree with the Hall Commission when it says:

> "The general impact of a transport subsidy, such as the Feed Freight Assistance Program, can be postulated even without the aid of empirical evidence. Since the subsidy applies only to feed grains, and not to livestock or livestock products, it encourages the shipment of feed grains rather than livestock or livestock products from the Prairies to Eastern Canada and British Columbia. As a result, livestock production (and particularly feed lot operations) shift away from the prairies and closer to centres of consumption such as Toronto, Montreal, and Vancouver " (HCR, Vol. I, p.302).

As noted, the subsidy has been stable, and today it is probably not a very significant factor in the continuing development of local eastern feedlots and the eastern meat packing industry since a large amount of feed is imported for these purposes from the U.S. (HCR, Vol. I, p.303). However, we would certainly agree with the Hall Commission that the net effect can be concluded <u>even without additional empirical evidence</u> to have biased, and to continue to be biasing, the location of industry in favour of eastern centres, and here we would argue that the subsidy does represent a distortion, albeit a small one, since its effect is to cause feedlot

operators to react to a price which is less than the social cost. Parenthetically, we would add that the same argument applies to any subsidy, while recognizing that some subsidies may be justified on income distribution grounds.

But not only is it the case that imports from the U.S. and local feed grain production provide an alternative input for eastern producers; the structure of costs of inputs and products in these industries is such that the effect of transportation rates is slight and adjustments would probably not alter the location of the industry, as analysis in the study done for the Federal-Provincial Committee on Western Transportation, discussed in Section III above, showed.

The FPCWT Report concluded that there would be little short term or long term effect on the meat packing and livestock feeding industries from these rate revisions. We emphasize, however, our basic agreement with the Hall Commission Report on certain of its diagnoses relating to the location of these industries: the subsidies represent distortions and should be eliminated, however small their effect may be. In addition, the CTC might do well to review some of the rate premiums, discounts, and surcharges with a view to determining whether they reflect abuse of market power or the creditable attempt to discriminate in the recovery of joint costs.

Before leaving this section we might point to an inconsistency in the Hall Commission's Report. The Report recognizes that while many in the west are opposed to the Feed Freight Assistance Program, as well as any other aspect of the rate structure which seems to give an unnatural advantage to the eastern producers, the "Prairie Feed Grain Producers, as a group, are in favour of continuing the Feed Freight Assistance Program because it provides them with an advantage in serving one of their markets for feed grains " (HCR, Vol. I, p.303). Thus, removal of the subsidy may actually hurt some prairie producers. But, again, we would

not view this as justification for not discontinuing the present system of subsidies with their attendant distortions.

G. Provincial Compensation for Road Costs

It will be recalled that 2,165 miles of branch lines were recommended for abandonment by 1981. Following this abandonment, it is expected that most of the grain now carried on these lines will be diverted to truck transport. The prairie provinces will incur higher road costs, and it is recommended that federal assistance be extended. The Hall Report provides several careful studies of the impact of this road traffic on highway expenditures. It performs a careful analysis of the choice of road vs. rail on the routes in question and, in choosing road transport, it does seem to reach a least cost conclusion. It is not this choice which is at issue here. Rather, what is at issue is the significance of the proposal and of the analysis for the evaluation of the efficiency of highway user charges, which has implications far beyond the narrower question of the desirability of implementing the Hall recommendations.

The Hall Report considers various road transport options, including farm truck (F, R, or FT license plates) and commercial common carrier. The user charge structure in the three subject provinces is made up principally of fuel taxes and annual registration fees, with the farm trucks in the provinces paying much lower annual fees than common carriers, but apparently paying the same fuel taxes (Stat. Can., The Motor Vehicle, Part I, 1971). Such was the situation in 1971, at least.

The Hall Commission did not analyze the revenues to the province that would be generated by the increased motor vehicle use. Clearly, if the present user charge structure outside the farm truck sector is sound, in the sense that every vehicle is paying at least its directly variable cost,

truck transport of grain in farm trucks will result in a shortfall between incremental revenues and incremental costs, since the vehicles in the new traffic would be paying a much smaller annual charge than the directly variable cost of their activity. There would not seem to be any justification for this on the ground of equity unless it could be shown that the farmers affected fell below some agreed upon poverty line. From an efficiency point of view, it is certainly objectionable since it would constitute a serious divergence between the incremental cost of the truck on the network during the year, and the total price paid by that truck for the use of the road.

The Hall report also discusses the possibility of common carriers or commercial trucking. But it never brings together and confronts the implied cost in the form of road maintenance to move grain by this method, and the implied revenue generated through user charges of this traffic, restricting its analysis to the issue of which is cheaper, road or rail. And the report is undoubtedly correct in prefering rail. But our concern here is what this implies about the user charge structure in general. For if the traffic does go by commercial carriers which do pay the full annual registration fee, and still there is a shortfall between user charge revenues and incremental highway costs, i.e., the directly variable costs of this traffic, the unavoidable conclusion is that the present user charge structure is not sound and that the big trucks are not paying for the costs that they impose on the system. This would be a distortion in the price system which encourages the use of the wrong truck size, possibly distorts the location of industry, and perhaps even biases the final mix of goods and services produced in the economy. The author has believed for many years that a study was long overdue into the question whether there are large subsidies from outside the intercity road transport sector (which should be defined to exclude intra-urban transportation) to that sector. The fact that a large part

of these subsidies originates in fuel tax revenues (generated in cities) is irrelevant. Contributions such as those originating in automotive fuel taxes generated in cities are and should be recognized as subsidies to the intercity road transport sector since the two activities are separate and their pricing should not be interpreted as an attempt to discriminate in the recovery of joint costs. We would also be against any further such subsidization of this industry which, like most of the subsidies so far discussed, simply represent further distortions in the price system.[7]

H. Compensation for Tax Loss

Communities which lose some of their tax base will have lower tax revenues. The Hall Commission points out that, although some expenditures will fall, the total expenditure will not fall as much as total tax revenues. It is argued that the difficulty in which the affected communities then find themselves should be alleviated by outside compensation in an amount equal to five years of taxes.

While generally sympathetic to the desire to relieve the affected communities of the hardship attending the disappearance of what is in some cases a very large share of their tax base, we would recommend two qualifications to the recommendations of the Hall Commission Report. First of all, there is apparently a significant residual value in the facilities being abandoned. If the local communities took title to these facilities, there might be some revenue from

---

[7]We recognize the difficulty of determining highway costs since both joint costs and directly variable costs are involved. It is difficult to determine a basis for apportioning joint costs and there has been a great deal of controversy over the years concerning the definition and behaviour of the directly variable costs. An analytical approach to this problem, together with a case study, is provided in Abouchar 1977, Chapter 5 and 8.

their further disposition, and any tax loss compenstion should be adjusted accordingly. The Commission advocates that the disposition of such property be made in consultation with local governments (HCR, Vol. I, p.518), but it does not propose to adjust accordingly the outside offset to taxation losses.

The other qualification relates to the schedule for granting this offsetting assistance. The Hall Commission recommends that five year's tax loss equivalent be provided directly upon abandonment of the facilities (HCR, Vol. I, p.517). The reasoning for such a schedule is not given. We would think it preferable to make such grants annually and on a decreasing basis in order to permit the local government to plan better the phasing out of certain operations. If the recommended five years is accepted, we would suggest that the funds actually be disbursed over a period of perhaps eight years, with the revenues decreasing in some manner.

K. Statutory Grain Rates

Finally, the statutory grain rates were singled out as an area involving recommendations with national implications. We believe that enough has been said in our analysis to justify our recommendation that all statutory bases for freight rates, with the possible exception of the Maritime Freight Rates Act, be reviewed and probably eliminated on the grounds that they represent distortions in the Canadian price system.[8] To argue that there are distortions in other

---

[8]Although there is no agreement on how much loss the Crow's Nest Pass rates entail, that there is some loss on grain traffic has been increasingly recognized since the MacPherson Royal Commission Report in the early 1960's. (See the study by Reid in the Royal Commission Report). More recently, the Commission on the Cost of Transporting Grain by Rail believes the cost to be in excess of the Crow's Nest Pass Rates (HCR, Vol. I, p.336) and some estimates put the shortfall at 35-50 percent.

parts of the price system is not sufficient ground for doing nothing to correct these distortions. Ideally, the economy would move in the direction of eliminating all such distortions which hinder the efficient forward movement of the Canadian economy and its position in the international economy.

REFERENCES

Abouchar, Alan, Transportation Economics and Public Policy: with Urban Extensions. New York: Wiley-Interscience, 1977

Currie, A.W., Canadian Transportation Economics, Toronto: University of Toronto Press, 1967

Darling, Howard J., An Historical Review of Direct Transport Subsidies in Canada, Canadian Transport Commission, June 1975 (ESAB 75-8)

(FPCWT) Two Proposals for Rail Freight Pricing: Assessment of Their Prospective Impact. A report to the Federal-Provincial Committee on Western Transportation, September 1974

(HCR) Grain and Rail in Western Canada, The Report of the Grain Handling and Transportation Commission (Hall Commission), 1977 (Vols. I and II).

Reid, E.P., "Statutory Grain Rates", in Royal Commission on Transportation (MacPherson Commission). Vol. III, Ottawa, July 1962.

Statistics Canada, The Motor Vehicle, Part I, Rates and Regulations, 1971

Statistics Canada, Railway Transport, Part I, Comparative Summary, Statistics, 1975

The Globe and Mail (Toronto), various issues.

Ontario Economic Council Discussion Papers

An Economic Analysis of the Hall Commission Report
A. Abouchar

Emerging Problems in Post-Secondary Education

These publications are available from the Ontario Government Bookstore,
880 Bay Street, Toronto, Ontario M7A 1N8